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Repairs and Change of Accounting Method: Not Quite to the End of the Road

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Repairs and Change of Accounting Method: Not Quite to the End of the Road

-by Neil E. Harl*

The sentiment was widespread, when *Rev. Proc. 2015-20*[1] was issued on February 15, 2015, that the long-running saga of the line drawn between deductible repairs on the one hand and capitalized expenditures on the other had about come to a close with an unexpected link forged with change of accounting methods.[2] The long-running battle between taxpayers and the Internal Revenue Service dating from the taxpayer victory in 2000 in *Ingram Industries , Inc. and Subs. v. Commissioner*[3] and the 2005 Court of Appeals decision in *FedEx Corp. v. United States*,[4] through the issuance of proposed regulations in 2006, 2008, the temporary regulations in 2011[5] and the final regulations in 2013 seemed to be coming to a close.[6] That array of developments was followed by a blizzard of six revenue procedures.[7] It became clear that the Internal Revenue Service, even with nearly a decade of pushing tax reform in this area, was ill-prepared to provide clear, unambiguous guidance to taxpayers and tax practitioners.

Messages from Rev. Proc. 2015-33

The principal message in newly released *Rev. Proc. 2015-33*[8] deals with I.R.C. § 446(e) and Treas. Reg. § 1.446-1(e) which indicate that the end of the road may have already been reached but not as portrayed earlier by IRS.

Section 446(e) of the Internal Revenue Code states –

"Except as otherwise expressly provided in this chapter, a taxpayer who changes the method of accounting on the basis of which he regularly computes his income in keeping his books shall, before computing his taxable income under the new method, *secure the consent of the Secretary*." (emphasis added)

Treas. Reg. § 1.446-1(e) states –

"(1) A taxpayer filing his first return may adopt any permissible method of accounting in computing taxable income for the taxable year covered by such return. Moreover, a taxpayer may adopt any permissible method of accounting in connection with each separate and distinct trade or business, the income from which is reported for the first time.

"(2) Except as otherwise expressly provided in Chapter 1 and the regulations thereunder, a taxpayer who changes the method of accounting employed in keeping his books shall, before completing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. Consent must be secured whether or not such method is proper or is permitted under the Internal Revenue Code or the regulations thereunder."

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The consequences of *Rev. Proc. 2015-33*

What *Rev. Proc. 2015-33*[9] seems to be saying is that newly organized firms, authorized by *Rev. Proc. 2015-20*[10] can use the "simplified procedure" outlined in *Rev. Proc. 2015-20*[11] provided the conditions for the "simplified procedure" are otherwise met. However, that avenue is not open for taxpayers wishing to *change* their method of accounting and those firms must secure consent of the Commissioner. Thus, it essentially narrows the eligibility to use the "simplified procedure" to new, start-up, firms.

Address for copies sent to Ogden, Utah

Rev. Proc. 2015-33[12] also states that a signed copy of Forms 3115 is to be sent to the Ogden, Utah address specified in Rev. Proc. 2015-1[13] which is—

Internal Revenue Service
1973 N. Rulon White Blvd
Mail Stop 4917
Ogden, Utah 84404

However, if the Form 3115 is sent by certified mail, it should be sent to –

Internal Revenue Service
1973 N. Rulon White Blvd
Mail Stop 4917
Ogden, Utah 84201-1000.

Applications on Form 3115 are to be filed under the transition rule provided in *Rev, Proc. 2015-33*,[14] as specified in Section 3.02 thereof (referring back to *Rev. Proc. 2015-13*),[15] with the IRS in Ogden Utah *and not with the national office of the Internal Revenue Service* despite the requirement in *Rev. Proc. 2011-14*[16] that copies of applications were to be sent to the national office.

ENDNOTES

[1] 2015-1 C.B. 694.

[2] See Harl, "Changing From Accrual to Cash Accounting: Watch Your Step," 26 *Agric. L. Dig.* 65 (2015). See also 1 Harl, *Farm Income Tax Manual* § 1.07[1][c] (Matthew Bender 2015); Harl, "At Last—Relief From the Repair Regulations," 26 *Agric. L. Dig.* 33 (2015).

[3] T.C. Memo. 2000-323 (overhaul of towboat diesel engines out of action for 10-12 days, held to be "repairs").

[4] 291 F.Supp. 2d 699 (W.D. Tenn. 2003), *aff'd,* 2005-1 U.S. Tax Cas. ¶ 50,186 (6th Cir. 2005) (four part test of (1) whether taxpayer treated component part as part of larger unit of property for any purpose; (2) whether the economic life of a component was co-extensive of the larger unit; (3) whether the larger unit and smaller unit can function independently; and (4) whether a component part can and is maintained while affixed to the larger unit; aircraft was single unit of property so costs of engine shop visits deductible).

[5] T.D. 9564, Dec. 23, 2011, 2012-1 C.B. 614.

[6] T.D. 9636, Sept. 13, 2013, 2013-2 C.B. 331.

[7] Rev. Proc. 2014-16, 2014-1 C.B. 606; Rev. Proc. 2014-54, 2014-2 C.B. 675 (which was 62 pages in length); Rev. Proc. 2015-13, 2015-1 C.B. 419; Rev. Proc. 2015-14, 2015-1 C.B. 450; Rev. Proc. 2015-20, 2015-1 C.B. 694; Rev. Proc. 2015-33, 2015-1 C.B. 1067.

[8] 2015-1 C.B. 1067.

[9] 2015-1 C.B. 1067.

[10] 2015-1 C.B. 694.

[11] 2015-1 C.B. 694.

[12] 2015-1 C.B. 1067.

[13] § 9.05(4), 2015-1 C.B. 1.

[14] 2015-1 C.B. 1067.

[15] § 15.02(1), 2015-1 C.B. 419.

[16] 2011-1 C.B. 330.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

EXEMPTIONS

IRA. The debtors, husband and wife, filed for Chapter 7 and claimed an IRA as exempt under Section 522(d)(12) of the federal exemptions. The creditors objected to the exemption on the basis that the IRA was no longer exempt from taxation because the IRA had engaged in prohibited transactions under I.R.C. § 4975(c). The evidence showed that, prior to the bankruptcy filing, the IRA entered into a partnership with an LLC owned by the debtors. The debtor husband directed the IRA trustee to distribute funds which were used to acquire real property which was contributed to the partnership along with other IRA funds. The court held that the IRA was not eligible for the exemption because the debtor husband was a disqualified person who engaged in a prohibited transaction with the IRA in purchasing land and contributing it to the partnership in exchange for an interest in the partnership. ***In re* Kellerman, 2015-1 U.S. Tax Cas. (CCH) ¶ 50,331 (Bankr. D. Ark. 2015)**.

LIEN AVOIDANCE. The debtors filed for Chapter 7 and the claims included a priority mortgage and a junior mortgage against the debtors' home. The primary mortgage amount exceeded the fair market value of the home; therefore, the junior mortgage was unsecured. The debtors sought to void the junior mortgage under Section 506(d). Section 506(d) provides, "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." The court cited *Dewsnup v. Timm, 502 U. S. 410 (1992)* which construed the term "secured claim" in Section 506(d) to include any claim "secured by a lien and . . . fully allowed